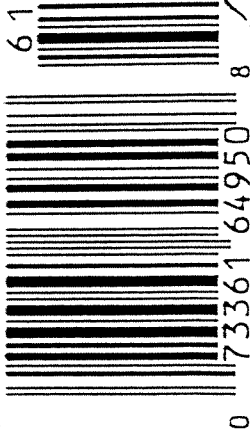


SPRING/SUMMER 1996

MEDIA STUDIES Journal

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MERGERS



 MEDIA STUDIES CENTER

Media Regulation— New Rules for New Times

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IN AN ERA OF MEDIA MERGERS and cyberspace, any discussion of media structure should begin with this question: Are American media becoming more concentrated and controlled by a mere handful of companies capable of affecting politics and economics?

There are several reasons why the answer to this question is not an obvious “yes,” despite the many recent media mergers. First, the media market as a whole, defined as the market for broadcast, cable, computers, software, print and content, has grown rapidly. While the fish in the pond may have grown in size, the pond grew, too.

To analyze the situation it is necessary to get some basic facts on concentration in the different industries that make up electronic media. Consider broadcasting. Concentration of ownership of radio stations nationwide is not substantial. In 1995, there were almost 12,000 U.S. radio stations. Yet the largest owning group, Jacor, owned only 54 stations. From 1987 to 1995, as regulatory ceilings were loosened, the percentage of the industry’s revenue produced by stations owned by the top four group owners increased from 8.1 percent to 11.7 percent. In 1996, nationwide ownership limits for radio stations were eliminated altogether. This will likely lead to significantly larger radio station groups. Jacor, for example, has already bought or is about to

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Rupert Murdoch arrives at a Federal Communications Commission hearing, May 1995.

buy 30 or more additional stations. But it would take vast purchases for the national market to become concentrated. On the other hand, since *local* ceilings on radio station ownership were increased from one AM and one FM station per market before 1992 to up to eight stations in large markets today, instances of local concentration may occur.

In television, with the loosening of the limitations, concentration of ownership of TV stations nationwide increased from 1983 to 1995. The percentage of industry revenues earned by the top four owner groups grew from 15.2 percent to 22.2 percent. With the acquisition of CBS by Westinghouse, this will increase to about 25.8 percent. In most other industries, this share would not indicate a concentrated market.

Cable television shows significantly greater concentration. Locally, in 1992, only 1.5 percent of homes passed by cable had a choice of more

than one cable operator. The top three cable firms serve 26 percent of cable subscribers and are vertically integrated into program supply.

THE TREND IN PROGRAMMING sources shows great openness. Early radio was dominated by three networks: one owned by CBS and two by NBC. (The government forced NBC to divest one of these networks, which became ABC.) In 1938, 341 out of 660 radio stations were network affiliates. Today, commercial radio networks as a whole have been losing listeners, while the largest radio networks have grown slightly. The share of radio audiences held by the market leader, Westwood One (which had acquired NBC's radio network), increased from 6 percent in 1991 to 9 percent in 1995 as a result of acquisitions. This figure does not suggest market power. At the same time, the public radio network market also became more competitive, due to a government funding policy change in 1985 that enabled the emergence of competitive public radio networks such as Public Radio International.

In broadcast television, as a result of competition from cable networks and new Hollywood-affiliated broadcast networks (such as Fox, WB and UBN), the prime-time audience of the Big Three networks (ABC, CBS and NBC) dropped from 92 percent in 1976 to 53 percent in 1996.

In cable television, the diversity of programming has greatly expanded. In 1995 alone, 60 new channels were offered to cable networks, adding to the more than 50 channels that were already widely available. None of the cable networks individually attracts even 2 percent of the nationwide TV audience. Cumulatively from 1991 to 1995, the viewership of the top eight cable networks increased from 6.9 percent to a still-low 8.8 percent.

THE TELECOMMUNICATIONS industry was distinguished for a century by AT&T's near monopoly until the 1970s when regulatory and technological forces combined to promote competitive entry. Even after the breakups, the various local exchange carriers retained monopoly. Today, competitive access providers (CAPs) account for less than 1 percent, but their share has been increasing,

especially among business customers, in those states that permit competition. The Telecommunications Act of 1996 oversees local competition in the remaining states. As a result, the local exchange market will likely be subject to more active competition by long-distance carriers, wireless providers, cable companies and resellers.

In long-distance telephone service, AT&T's market share fell considerably from 90 percent in 1984 to 55 percent in 1994. MCI and Sprint have about a quarter of the market; 500 other companies, mostly small resellers, account for 17 percent. The 1996 Telecommunications Act permits the Baby Bells to enter long distance, subject to opening of the local market. This, together with arbitrage by resale and new technological approaches such as "Internet phone service," is likely to drive prices further down and prevent oligopoly.

The contours of concentration in the computer field have shifted dramatically, too. Once, IBM dominated the U.S. computer industry; in 1969 it held more than 70 percent of market share. But technological developments, strategic mistakes at IBM and the shift from mainframes to PCs changed everything. In the critical microcomputer market, the top manufacturer in 1994 was Compaq with 12.8 percent. IBM's share was only 10.2 percent.

Concentration in the computer industry shifted to the operating system. Today, Microsoft operating systems are dominant. Partly due to its strength in operating software, Microsoft was able to reach market leadership positions in several important applications of software. This has fostered both a government antitrust lawsuit and an ongoing debate over the potential of competition through alternative technologies such as "network computers" that are independent of any particular operating system.

FROM A DISTANCE, THE MERGERS and the increase in revenues generated by the major communication companies during the 1980s suggest an industry dominated by a few increasingly powerful firms. But a closer look at the corresponding market shares for the dominant communication companies of 15 years ago reveals that these companies are indeed bigger, but their control of their industry has declined. AT&T's revenues, despite its

divestiture, increased from \$40 billion in 1979 to more than \$75 billion in 1994 (before its voluntary second divestiture that spun off equipment manufacturing and reduced the figure to \$49 billion). Even so, AT&T's share of the information industry dropped from 24.4 percent to 11 percent (7 percent after the second divestiture). IBM revenues grew from \$22.8 billion in 1979 to \$64 billion in 1994, yet its share dropped from 13.6 percent to 9.4 percent. CBS, with revenues almost static at over \$3 billion, saw its market share drop from 1.9 percent to 0.5 percent from 1979 to 1993. Only ABC, after mergers with Capital Cities and Disney, became part of a much larger media firm, accounting for 2.1 percent of communications instead of 0.2 percent in 1979.

What is the reason for these declines? The communication industry as a whole has exploded in the 1980s and '90s. And most of the growth occurred in the cable TV and microcomputer industries, which virtually invented themselves in this period. As new giants and small firms have emerged in these industries, the larger pie has been divided among more participants. In parallel, the advent of multichannel media has increased the diversity of delivery platforms and content available to users.

This is true for national concentration. But on the local media level, markets often remain concentrated because economies of scale exist that make entry difficult for additional telephone carriers, cable companies and newspapers. Thus, most homes have no choice in cable providers, and alternative local telephone providers have rarely served residential customers. Competition in multichannel video delivery and in local telephony is beginning to emerge only now. The Telecommunications Act of 1996 makes competition between cable and telephone companies likely: They will begin to compete in one another's markets in many local areas, substituting the economies of scope of multiple products for economies of scale. In addition, wireless delivery services for voice and multichannel video are offering increasing competition in these markets. Electronic delivery will also compete as an advertising vehicle with local newspapers, but that will only raise entry barriers to other newspapers.

WHAT ARE THE IMPLICATIONS of these numbers? Electronic media industries in the United States have been evolving through three stages: in the past, the stage of *limited* media; now, *multichannel* media; and in the future, *cyber*media. Today we are constructing a new media system that is fundamentally different from its predecessors. Any regulatory system is therefore likely to be quite different from previous ones. The lengthy stage of limited media was defined by monopoly or oligopoly. Federal and state governments therefore set forth regulations to contain the market power of the few players: limits on broadcast station ownership, cross-ownership restrictions, rate regulation and limits on phone company activities. (These restrictions also often had the goal of protecting the exclusivity of those firms.)

Today's much more open multichannel media system dates, ironically, to about the year 1984, when media broke free from restriction on several fronts: Cable TV was deregulated, the telecommunications monopolist AT&T was split up, and the government had just dropped its antitrust suit against IBM due to the firm's loss of domination. In the multichannel phase, many of these restrictions were changed or lifted, as exemplified in the fundamental and sprawling Telecommunications Act of 1996.

Yet there is concern that regulatory liberalization has not led to openness and competition but to a new level of media concentration. And indeed, recent years have witnessed the expansion of large media firms in the United States through mergers, acquisitions and expansion. As a result, a small group of very large media firms—like AT&T and IBM—has emerged with revenues up to the \$65-\$80 billion range. (Although in comparison, General Motors, the largest U.S. firm, is two to three times as large.)

IN THE CYBERMEDIA STAGE, the lines between transmission systems blur as telephone communications, mass media transmissions and computer data exchanges are combined over an integrated, interconnected system of multiple digital broadband networks linked to video servers. In this context, continued use of a regulatory system that places different functions in a discrete regulatory box,

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Westinghouse Chairman Michael H. Jordan and CBS Chairman Laurence Tisch shake hands after their merger announcement, August 1995.

and highlights the distinctions between them with cross-ownership prohibitions and other differentiated treatment, would be unworkable. It will also be largely unnecessary.

In the stage of limited media, regulation was justified by the principle of scarcity. When electronic media were so limited that only a few could gain access, regulation was required to ensure that those few served the needs of society without accruing undue benefit from their privileged position. In the stage of multichannel media, regulation was to prevent those with control over the gateways to the multichannel delivery systems from excluding competing providers from subscribers' homes.

In the cybermedia future, scarcity and gatekeepers will be largely eliminated. The future will not be one of 5,000 channels. Rather, it might well be, in the extreme, a future of *one* channel, an individualized channel for each individual, composed of various content components,

assembled by personal electronic agents seeking a favored constellation of programs from a large menu of supply and delivery options. And there will no longer be an economic rationale for synchronous mass-audience channels once cybermedia enables advertising to be decoupled from content and targeted to specific viewers or classes of viewers regardless of what they view at that moment.

In such an environment, it is unlikely that sprawling media conglomerates combining all aspects of media will be successful. Vertical integration loses its power and becomes a drag. Different divisions of the same company would have competing objectives. To act with optimal efficiency in an open, competitive environment, each segment of a company must be willing to buy, sell or joint-venture with companies that compete with its parent company, if the rival offers better terms. Without market power in one market to leverage into another, extensive vertical integration rarely makes economic sense.

While there is much hype about the synergies created by vertical mergers, without market power at some stage of production, these benefits tend to be illusory. Hence, competitiveness in all segments of the communications industry is likely to reduce the economic logic for vertical integration and lead to more focused firms. Some companies are likely to re-strategize and follow a "systems integration" approach, in which they do not own or operate the various activities of production and transmission but rather select optimal elements in terms of price and performance, package them together, manage the bundle and offer it to the customer on a one-stop basis. This will not require an actual physical presence in each stage or region; consequently, entry barriers will be lower.

THE PRIMARY RATIONALE for regulation has been the need to compensate for the imbalance of power between huge monopoly suppliers and small and technically ignorant users. In a converged environment with full choice, however, the imbalance will change. This will largely resolve traditional problems of price, quality, security, privacy and content diversity.

For some time, however, there will still be a need for regulation to create or ensure interconnection among networks and to maintain sup-

port mechanisms for universal connectivity. Since the media of the future will be more essential than ever to society—not just for entertainment, but for information, education, social services, work and participation in society and the economy—the value to society of having all its members connected will be more important than ever. Given the reality of politics, government is not likely to disappear from this area.

It is naive to argue, as many Internet enthusiasts do, that any regulation becomes “impossible.” True, determined users can undercut any restriction. But as Internet applications create platforms for vast economic transaction, society will extend the scope of its controls, however wise or misguided they are, to the electronic medium and to the major players serving or using that medium. The notion that one cannot control the Internet is therefore ultimately deeply pessimistic, because it is a message of technological determinism in which society is seen as helpless. This is incorrect empirically and objectionable politically. We should choose liberty because we want to, not because we have to.

The United States has invested, at great political cost and effort, in a diverse communications structure. Today, the result is a dynamic market with considerable technological, artistic and business entrepreneurialism. Users have more choices and more tools for production, and the newest media system, the Internet, is a marvel of decentralization, democratic spirit and innovation. In that environment, traditional market structures are being eroded and recast. Major firms are vigorously trying to extend their activities vertically and horizontally. But as they grow, they also overlap and compete. There is no evidence of dominance comparable to the old triumvirate of AT&T, IBM and ABC/CBS/NBC. And should some dominance continue or be newly established, and not be contained by competitive market forces, reregulation will no doubt return by popular demand.
